Supreme Court, U. S.
FILED
JUL 10 1979
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

No. 78-1842

SAM GOLDMAN,
Petitioner,

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., THE HONORABLE JAMES H. MEREDITH, CHIEF JUDGE, THE HONORABLE JOHN J. NANGLE, JUDGE, and W. H. BLUMENTHAL, SECRETARY OF THE TREASURY,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

For Merrill Lynch, Pierce, Fenner & Smith, Inc.

EVANS & DIXON
HENRY D. MENGHINI
GERRE S. LANGTON
314 North Broadway
St. Louis, Missouri 63102
(314) 621-7755
Attorneys for Respondent
Merrill Lynch, Pierce, Fenner & Smith, Inc.

St. Louis Law Printing Co., Inc., 812 Olive Street 63101 314-231-4477

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OPINIONS BELOW

The opinions delivered in the courts below are as stated by petitioner and are appended to the petition for Writ of Certiorari.

JURISDICTION

Respondent does not question the jurisdictional statement as set forth in the petition.

QUESTIONS PRESENTED

Petitioner misstates the nature of the legal issue or issues sought to be reviewed. These issues are:

I. Is it a departure from accepted judicial standards of review for the Court of Appeals to deny an appellant a new trial on an erroneously dismissed cause of action when the evidence below shows that the petitioner would not be entitled to recover upon any theory because petitioner was unable to show that he was defrauded?

II. Is it a departure from accepted standards of review for the Court of Appeals after careful review of the evidence below, to determine that the District Court considered all evidence presented by petitioner on each of petitioners' theories of recovery and permissably found that respondent Merrill Lynch committed no violation of the Commodities Exchange Act?

III. Is it a departure from accepted judicial standards of review for the Court of Appeals to determine that the District Court findings of fact, which were based to a large extent upon the credibility of the witnesses, were not clearly erroneous and that any error was not prejudicial?

IV. Does the violation of a broker's own house rules create a private cause of action in a customer with respect to a commodity transaction?

V. Does 31 CFR 350.16 (b) create a haven for judgment debtors?

VI. If 31 CFR 350.16 (b) is construed to protect Goldman's Treasury Bills from execution and garnishment, is said regulation unconstitutional in that it violates the provisions of the Fifth Amendment to the Constitution of the U. S. in that it deprives Merrill Lynch of its property right without due process of law?

STATUTES AND REGULATIONS INVOLVED

In addition to the Statutes and Regulations Involved cited by petitioner, the following regulations are also involved: 31 CFR, Section 306.100, which read as follows:

§ 306.100 **Transferable securities.**

The Department will recognize valid judicial proceedings affecting the ownership of or interest in transferable securities, upon presentation of the securities together with evidence of the proceedings. In the case of securities registered in the names of two or more persons, the extent of their respective interests in the securities must be determined by the court in proceedings to which they are parties or must otherwise be validly established.

31 CFR, Section 306.101:

§ 306.101 **Evidence required.**

Copies of a final judgment, decree, or order of court and of any necessary supplementary proceedings must be submitted. Assignments by a trustee in bankruptcy or a receiver of an insolvent's estate must be supported by evidence of his qualification. Assignments by a receiver in

equity or a similar court officer must be supported by a copy of an order authorizing him to assign, or to sell, or to otherwise dispose of, the securities. Where the documents are dated more than 6 months prior to presentation of the securities, there must also be submitted a certificate dated within 6 months of presentation of the securities, showing the judgment, decree, or order, or evidence of qualification, is in full force. Any such evidence must be certified under court seal.

31 CFR, Section 306.01: Applicability of regulations:

These regulations apply to all U. S. transferable and non-transferable securities, other than U. S. Savings Bonds and U. S. Savings Notes, to the extent specified in these regulations, the offering circulars or special regulations governing such securities.

Respondent relies upon Constitution of the United States, Article I, Section 10 and Amendment V.

STATEMENT OF THE CASE

Plaintiff's statement of the case contains certain inaccuracies and rather than attempt to state each area of contention, respondent submits the following statement of the case:

For the sake of brevity and accuracy, respondent adopts as its Statement of Facts in Case No. 78-1427, the findings of fact made by the trial court (Petition Appendix, p. A-32 through A-38) and sustained by the Court of Appeals (Petition Appendix, p. A-4 to A-13) including the correction noted by the Court of Appeals that the finding that Merrill Lynch set the original trading margin of petitioner's account of $50,000.00 was not accurate. The margin limit was set at $25,000.00 by Merrill Lynch (Petition Appendix, p. A-8, Note 6).

Because Petitioner has made misleading statements on Page 6 of his petition regarding the allegations contained in Count II of the Second Amended Counterclaim, respondents hereby appends the Second Amended Counterclaim to this Brief as Addendum A, pp. B-1 to B-17, so that this court may accurately understand the trial courts finding that Count II was repetitious of Count I and III (see petitioner's Appendix A-27). In any event, the record below shows and respondent will hereinafter demonstrate, that Goldman tried both theories of commodity fraud and common law fraud, that the trial court understood Goldman's respective theories and after trial of the case rejected both.

The "gist" of Goldman's case as stated by counsel for Goldman in his opening statement at trial (Tr. 52; attached as Respondent's Addendum B, p. B-19) and as pleaded in Count I (Respondent's Addendum, B-1) was that Mr. Goldman was induced to purchase Mexican peso contracts by certain alleged misrepresentations that were made to him by Mr. Stephen Palmen, Merrill Lynch's account executive (Tr. 52), i.e. that there was no risk in investing in pesos and that there would be no devaluation of the peso until after December 1976 when a newly elected president of Mexico would take office (Tr. 53). The trial Judge declined to believe any misrepresentation was made by Palmen. (Petition Appendix, A-37).

Count II of the counterclaim alleged that the activities of Merrill Lynch and its employee Palmen regarding investment in Mexican peso contracts were part of an overall scene to defraud Goldman by getting Goldman to invest in the $50,000.00 Guided Investment Program. (Respondent's Addendum, pp. B-6, B-9). Goldman alleged in Paragraph 24 of his counterclaim that the activities of Merrill Lynch were wrongful in several respects, including that it caused excessive credits to be ex-

tended to Goldman, but defendant Goldman did not allege what he now claims as the "crux" of the alleged fraud (Page 6, Petition) "that Palmen, the broker, substituted false financial statements to his superior without Goldman's knowledge * * * in an attempt to make Goldman appear qualified for participation in this [the guided investment] program". Count II in all respects was repetitive of Count I and III and for this reason Judge Meredith dismissed Count II.

However, the trial court was appraised of Goldman's dual theories of fraud by counsel in his opening statement (Addendum B, pp. B-19 to B-25) and Goldman was allowed to introduce evidence on both theories. However, on Page 10 of the petition, Goldman attempts, by taking statements of the Court out of context, to make it appear that the court refused to hear evidence on Goldman's second theory of fraud. When the trial commenced, counsel for Goldman reserved his right to make an opening statement (Tr. 14). Thus, when counsel started to cross-examine Merrill Lynch's witness Boyton Hussey regarding the guided account program, Judge Meredith was not appraised of Goldman's theory of the case and did not believe that the evidence was relevant because Goldman did not invest in the program. (Tr. 43-44, 50-51; Petition, Page 10). At Judge Meredith's suggestion, petitioner's counsel then made an opening statement explaining that his case was based on two theories, common law fraud in that Merrill Lynch had induced Goldman to invest in pesos commodity contracts by representing that the peso was a safe investment (Tr. 52; Addendum B, p. B-20), and secondly, that Palmen made misrepresentations on the account information sheet reflecting Goldman's background and financial condition in order to qualify Goldman to invest in the Guided Investment Program (Tr. 54; Addendum B, p. B-21). Counsel further explained to the court that Merrill Lynch had a house rule that adopted the "Know Your Customer" rule of the New York Stock Exchange—that a brokerage firm is bound to

investigate its customer and evaluate his ability to trade in a particular security (Tr. 54).[1] [This second theory of fraud is sometimes referred to as Goldman's Count II theory of fraud.]

After the court was appraised of Goldman's dual theories at trial, the court permitted Goldman to introduce evidence about the Guided Investment Program (Tr. 242, 243), and to question Mr. Hussey about the amount of commissions earned by

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[1] Petitioner's claim that the trial court did not understand petitioner's theories of fraud and therefore did not try these issues is refuted in the transcript, Page 49 to 59, which portion of the transcript is included in Respondents' Addendum B to this Brief, Pages B-18 to B-25. The final exchange between counsel and the court was as follows (Tr. Pages 61-62):

> THE COURT: What we are talking about in this case is pesos, isn't it?
>
> MR. RADLOFF: We're talking about pesos and we're talking about how it tied together. In other words, Mr. Menghini has opened up the issue about they only received the $250 which is not a very great incentive for the fraud that we allege in this case and they are showing that there was something bigger than this immediate commissions on pesos which was the incentive for this overall scheme to defraud.
>
> The big money was to be made in this guided investment program and that is what Mr. Palmen was setting Mr. Goldman up for.
>
> THE COURT: Well, I think we're getting very far afield, and since this is before the Court, if you make it brief I'm going to let you get into it very briefly, but I don't think it has one single, solitary thing to do with this lawsuit, because he never got into it. There is no dispute about that.
>
> MR. RADLOFF: That's correct.
>
> THE COURT: And if they defrauded him in this peso deal, that's one thing. If they didn't, then that's something else.
>
> MR. RADLOFF: Again, Your Honor, the other aspect is the statutory provision making the attempt unlawful and that is why he did not go through with this.
>
> THE COURT: Yes, but there's no loss on his attempting to get into that thing.
>
> MR. RADLOFF: *No*, but, Your Honor, we feel we have to have the whole picture considered to appreciate this.
>
> THE COURT: Well, make it brief. Let's go.

Merrill Lynch and account executives on the average Guided Investment Account (Tr. 64-65). Goldman did not identify for the Court of Appeals and has not indicated in his petition, what, if any, other evidence he wanted to introduce with regard to the Guided Investment Program and the alleged attempted scheme to defraud Goldman by getting him to invest in said program. The trial court ultimately found that Goldman supplied the information found in his new account form (Petition Appendix, pp. A-34) and that Merrill Lynch and Palmen made no misrepresentations and committed no violation of the Commodities Exchange Act. (Petition Appendix, p. A-37). The Court of Appeals determined that the latter finding was based to a large extent upon the district court's evaluation of the credibility of the witnesses and was unable to say that the finding of the trial court was clearly erroneous. (Petition Appendix, p. A-10).

Count III of Goldman's counterclaim (Respondents' Addendum, pp. B-6 to B-9) alleged violations of Merrill Lynch's own house rules which required Merrill Lynch to use due diligence when approving new accounts in accordance with the responsibility imposed upon them by Rule 405 [of the New York Stock Exchange]. The trial court dismissed Count III because it believed that there was no private cause of action for violation of Merrill Lynch's House Rules. (Petition Appendix, p. A-30). The Court of Appeals took a broader view of the petitioner's allegations and must have believed that he also alleged violation of Rule 405 of the New York Stock Exchange Rules,[2] and Rule 27 of the National Association of Security Dealers.[3]

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[2] Rules of the New York Stock Exchange or National Association of Security Dealers do not apply to commodity transactions. *Hirk v. Agri-Research Council, Inc.*, 561 F2d 96 (7th Cir. 1977).

[3] Defendant's counterclaim does not refer to Rule 27 and it was not asserted or introduced at trial.

The Court of Appeals held that the trial court should not have dismissed Count III because Goldman did state a cause of action by alleging violations of "exchange and dealer association rules accompanied by allegations of fraud". The Court of Appeals found that since Goldman failed to prove fraud, even if Merrill Lynch were found to have violated the exchange or association rules, the violations, in the absence of fraud, would not constitute an independent basis for liability. (Petition Appendix, p. A-13).

As demonstrated with regard to respondent's statement concerning Count II, Goldman had ample opportunity at trial to develop his dual theories of "fraud". The trial court found that Merrill Lynch had made no representations to Goldman concerning the safety of the peso, and that Goldman, not Palmen had supplied the financial data found in the New Account Information Form, Exhibit 1. Goldman does not now, nor did Goldman state to the Court of Appeals, what other evidence bearing on these issues, the trial court refused to hear or what other evidence he would have offered at trial that he did not offer with respect to Merrill Lynch's alleged fraudulent acts.

Nor could the trial court's error in finding that Merrill Lynch had set Goldman's margin trading limits at $50,000 instead of $25,000, have prejudiced Goldman under any theory of Goldman's case. Goldman's statement at P. 12 of his petition that the trial court misunderstanding prevented proving that Palmen falsified Goldman's financial statement for the purpose of raising his trading limits from $25,000.00 to $50,000.00 is a misstatement of his own theory of the case and assumes facts that did not exist. Any alleged falsification of the New Account Information Form by Palmen, would have occurred prior to the time that Goldman's margin limits were set out by Mr. Hussey, (Tr. 37) and would not have been done to get the margin "raised". The Court understood that Palmen's alleged

motive for allegedly falsifying the New Account Information on the form was to get Goldman's margin set at $50,000.00 so that he was qualified to invest in the $50,000.00 Guided Investment Program.

* * * * * * *

Respondents adopt for their statement of facts in Cause No. 78-1622, the Court of Appeals statement in that case. (Petition Appendix, A-15 to A-18).

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I

The Court of Appeals in the Main Appeal, Cause No. 78-1427, Reviewed the Trial Court's Finding of Fact in Accordance With the Rule Stated in Federal Rule of Civil Procedure 52(a), the Accepted Standard for Appellate Review, and Found That the Trial Court's Findings Were "Not Clearly Erroneous" and Therefore There Is Nothing Which Calls for This Court's Supervisory Powers.

Basically, what petitioner seeks, in the guise of a claim that the Court of Appeals departed from the accepted standard of judicial appellate review, is for this court to review the findings of facts and conclusions of law of the trial court and to hold such findings to be clearly erroneous. The decision of the Court of Appeals was based upon the accepted standard of review, is in accordance with Rule of Civil Procedure 52 (a) and is clearly correct. When all the evidence is considered together, Goldman can only succeed in his case, by resolution in his favor of questions of fact decided adversely to him in the trial court and in the Court of Appeals. In order for Goldman to prevail herein, this court must conclude that the trial court's finding that Merrill Lynch's account executive Palmen did not make any representation to Goldman about the safety and stability of the peso was clearly erroneous and/or (2) that the trial court's finding that Goldman, not Palmen supplied the financial data in the New Account Information sheet was clearly erroneous. It is this latter finding which Goldman now contends was erroneous, for it is this finding which precludes him from recovery under Count II and Count III of his second amended counterclaim.

Petitioner initially contends that because the court dismissed Count II and III of Goldman's counterclaim, Goldman was unable to prove "fraud". (Petition, p. 16). More particularly, petitioner, in his statement of the case, pp. 10 and 11, and in the argument section of his Petition, p. 17, incorrectly asserts that the District Court did not consider Goldman's dual theory of fraud and that the court considered only the "peso deal" and not the allegation that Palmen supplied false financial data on the New Account Form in order to qualify Goldman for the Guided Investment Program. To support this assertion, petitioner has taken the trial court's statement out of context, (See Petition, Note 2 and 3, pp. 10,11). Respondent has indicated in its statement of the case, pp. 6, 7 infra, that the trial court understood both theories, heard evidence on both theories, and largely based upon the court's view of the credibility of the witness, found that Merrill Lynch "committed no fraud, no misrepresentations and no violation of the Securities [Commodities] Exchange Act".[4] (Trial Courts Conclusions of Law, p. A-37) (See also Goldman's opening statement at trial, Respondents Addendum, pp. B-19 to B-25.) The trial court believed that the fraud alleged in connection with the Guided Account Program had "nothing to do with the lawsuit" because Goldman was not damaged by the alleged fraud (Tr. 61 and 62; see Note 1, infra). At the trial of the case, Goldman agreed he was not damaged by the alleged attempted fraud. See Note 1, infra. Ultimately Goldman lost on this so-called theory of fraud

[4] The Court of Appeals in F. N. 6 of its opinion (Petition Appendix, A-9) correctly determine that the District Court's statement in finding that Merrill Lynch "committed * * no violation of the *Securities* Exchange Act" instead of the Commodities Exchange Act, was a clerical error and that the trial court understood that Goldman's case was a commodities case. This was evident when the court considered that the trial court in Paragraph 1 of its findings of fact, (Petition Appendix P. A-33) and in Paragraph 1 of its Conclusions of Law, (Petition Appendix P. A-37), found that jurisdiction of the cause was based upon the Commodities Exchange Act. (Trial Courts, Conclusions of Law, P. A-37)

because the court believed, based upon the credibility of the witnesses that Goldman, not Palmen supplied the financial data found in the New Account Form (Trial Court's Finding of Fact, Paragraph 6 and 8, Petition Appendix, pp. A-34, A-35). The conclusion can only be that Goldman was not prejudiced by the dismissal of Count II.

Nor was Goldman prejudiced by the dismissal of Count III. Goldman had to prove fraud in order to prevail on Count III, for no private right of action exists for violation of an exchange or dealer association rule in the absence of a finding of fraud. *Shull v. Dain, Kalman & Quail, Inc.*, 561 F.2d 152, 160 (8th Cir. 1977); *Lincoln Commodity Services v. Meade*, 558 F.2d 469, 474, Note 1 (8th Cir. 1977); *Carras v. Burns*, 516 F.2d 251, 260 (4th Cir. 1975). Goldman failed to prove fraud under either theory and therefore could not have prevailed on Count III. Cf. *Avern Trust v. Clarke*, 415 F.2d 1238, 1242 [4] (7th Cir. 1969), cert. denied 90 S. Ct. 997, 397 U. S. 963, 25 L. Ed.. 2d 555; *Gorham & Johnson, Inc. v. Chrysler Corp.*, 308 F2d 462, 469 [3] (5th Cir. 1962), cert. denied 83 S. Ct. 725, 372 U. S. 912, 9 L. Ed. 2d 719.

Goldman relies upon *McDonnell Douglas Corporation v. Green*, 411 U. S. 792, 800, 93 S. Ct. 1817, 1823 (1973), (Petition, p. 17) for the proposition that a litigant should be accorded the right to prepare his case and plan the strategy of trial with the knowledge that the dismissed claim was in the case. In the McDonnell Douglas case, the dismissed claim asserted a violation of Section 703 (a) (1) of Title VII to the Civil Rights Act of 1964, which forbids discrimination in employment decisions. The court tried the count based upon Section 704 (a) of the Act, which forbids discrimination against applicants or employees for attempting to protest or correct discriminatory employment conditions. This court rejected petitioner's contention that the trial court in fact tried both counts because both counts raised identical issues. This court found

that the question of discrimination in employment raised a broader issue than the issue tried under Section 704 (a), and specifically found that the trial court did not discuss Respondents Section 703 (a) (1) claim in its opinion and denied requests for discovery of statistical material which may have been relevant to that claim. See Note 10, 411 U. S. at 800, 93 Supreme Court at 1823.

The present case is distinguishable from the *McDonnell Douglas* case, in that in this case the trial court tried the basic facts issues involved in Goldman's Count I and II theory of fraud and made findings of fact with regard to both (See Findings of Facts, Petition Appendix, pp. A-34, A-35, Paragraphs 6, 8 and 9). Count III involved identical issues of fraud tried in Count I and II. In *McDonnell Douglas*, the trial court refused discovery of evidence relevant to a dismissed count. Here Goldman does not indicate in his petition nor did he indicate to the Court of Appeals what evidence the trial court excluded with respect to the issue of fraud alleged in Counts II and III which prejudiced his case.

Petitioner's final complaint centers around the Eighth Circuit's review of the trial court's finding that Goldman, not Plamen supplied false financial data on the New Account Form. Goldman contends that the New Account Form is "documentary" and should be treated differently (Petition, p. 19). In the final analysis, the question was who supplied the information in the form, Goldman or Palmen. The answer to this question depends on whether the court chose to believe Palmen or Goldman for their stories were diametrically opposed. Goldman testified that he was not given a copy of the New Account Form to fill out and that he did not see the form (Tr. 94). Palmen testified that when Goldman first came to Merrill Lynch's office on May 4, 1976, to inquire about purchasing peso future contracts, Palmen gave Goldman a packet of three documents to take home with him and that the New Account Information sheet

was one of them (Tr. 284, 285, 295). Palmen states that Goldman returned to Merrill Lynch on May 5 with the information completed on the form. (Tr. 285-286). Palmen further testified that it was Merrill Lynch's standard practice to take the information which the customer gave on this information sheet, discuss it with the customer and then have a secretary type the information on a similar form and discard the handwritten copy. The typed form has four copies which are distributed to different areas at Merrill Lynch (Tr. 286, 287). This was done in Goldman's case and Palmen signed the form as account executive, but the information on the form came from Goldman.

Other surrounding facts which may have influenced the trial court's finding in favor of Palmen and against Goldman, was that Goldman in July 1976 submitted a financial statement to Clayton Brokerage Company (Trial Exhibit 45) which contained financial data which Goldman admitted was erroneous, (Tr. 139) and which did not agree with Goldman's Exhibit J, which exhibit was Goldman's statement of his actual net worth in May 1976. (Tr. 121).

In any event, Palmen's account of what occurred was just as credible as Goldman's. Palmen's actions from the first in attempting to interest Goldman in the $50,000.00 Guided Investment Program would indicate Palmen must have believed that Goldman's assets were considerable, at least enough to qualify Goldman for the $50,000.00 program. Goldman admitted and the trial court found that Palmen tried to interest Goldman in the $50,000.00 program at the time of their first meeting, but that Goldman was never interested in the program, but only in pesos (Trial Court's findings, Petition Appendix, p. A-35, Paragraph 9).

The Court of Appeals considered the above evidence and was unable to say that the trial courts finding was clearly er-

roneous. (Petition Appendix, p. A-8). There is no basis for petitioner's charges that the Court of Appeals acted improperly.

Finally, the decision of the Court of Appeals, in affirming the trial courts judgment on Count III, is the correct result for Count III did not state a cause of action against Merrill Lynch. Count III alleged that Merrill Lynch violated its own house rules in several respects. (Respondents Addendum, pp. B-9 to B-15). It is respondents contention that allegations that a broker violated house rules do not state a cause of action by the customer against a broker and that the trial court was correct in so holding. (See trial court Memorandum, Petition Appendix p. A-29). Judge Meredith was convinced that the house rules were made for the protection of the broker, not the customer. See *Colonial Realty Corporation v. Bache & Co.*, 358 F2d 178, 182 (2nd Cir. 1966).

The Appellate Court's belief that Goldman's Count III was based on a violation of Stock Exchange Rules and Security Dealer Association Rules was not correct. In the first place, rules of the New York Stock Exchange and the National Association of Security Dealers would not apply to this transaction which involved only commodities. *Hirk v. Agri-Research Council, Inc.*, 561 F2d 96, (7th Cir. 1977). Goldman pleaded and introduced Rule 405 of the New York Stock Exchange, only because it was incorporated by reference in Merrill Lynch's house rules, but this would certainly not give it force and application as a *breach of an Exchange Rule*. National Association of Security Dealers Rule 27 was not pleaded by Goldman and not asserted at trial. Since Count III of Goldman's counterclaim did not state a cause of action against respondent, the trial court properly dismissed Count III and the Court of Appeals in affirming acted properly, although for a different reason. Since the Court of Appeals reached the correct result, there is no reason for this court to intervene.

II

A

The Court of Appeals Correctly Held That Treasury Regulation 31 CFR Section 350.16 (b) Did Not Exempt Goldman's Book-Entry Treasury Bills From Execution and Judicial Process and Therefore There Is No Reason to Review Its Opinion.

The Court of Appeals correctly decided in Cause No. 78-1622, *U. S. ex rel. Goldman v. Meredith et al.*, that in the absence of an express directive, it would not create a sanctuary for judgment debtors by construing Treasury Department regulations in a manner that would insulate petitioner's book-entry treasury bills from judicial process. (Opinion, Court of Appeals, Petition Appendix, A-23).

Book-entry treasury bills are a new form of government securities. They are issued in the form of an entry in the records of the Federal Reserve Bank or the Treasury; there is no engraved certificate or other tangible evidence of indebtednss. The depositor receives only a confirmation of his transaction in his book-entry account. (Opinion, Court of Appeals, Petition Appendix, A-22, A-23). Treasury bills in definitive form are no longer issued to the general public. (31 CFR Section 349.1(c).) Therefore, if 31 CFR Section 350.16 (b) is construed to prohibit recognition by the treasury department of valid judicial process in aid of execution on a judgment against a debtor-depositor, debtors, such as Goldman, by placing their assets in book-entry treasury bills could shield them permanently from execution and garnishment.

The Court of Appeals correctly determined that 31 CFR Section 350.16 (b) must be construed with the general regula-

tions governing U. S. securities. 31 CFR Section 349.2[5] specifically provides that book-entry treasury bills shall be subject, to the extent applicable, to 31 CFR Part 306, the general regulations governing United States Securities. 31 CFR Section 306.100 provides that the "Department will recognize valid judicial proceedings affecting the ownership of or interest in transferable securities, upon presentation of the securities together with evidence of the proceedings." The Court of Appeals held that 31 CFR Section 306.100 and 306.101 "demonstrate that the Treasury Department will recognize judicial process given the appropriate evidence." (Opinion, Court of Appeals, Petition Appendix, p. A-23).

Goldman argues that the Court of Appeals errored in holding that 31 CFR 306.100 was applicable to book-entry treasury bills. Goldman reasons book-entry treasury bills are not "Transferable Securities" as defined by Section 306.2 (q), therefore making Section 306.100, which pertains to transferable securities, inapplicable. (Petition, pp. 21-23). Section 306.2 (q) defines "transferable securities" as follows:

> "Transferable securities, which may be in either registered or bearer form, refers to securities which may be sold on the market and transfer of title accompanied by assignment and delivery if in registered form, or by delivery only if in bearer form."

Book-entry treasury bills may be sold on the market. They are sold daily through member banks. Although transfer is

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[5] 31 CFR Section 349.2 provides:

The Treasury bills, the issue and sale of which are herein provided, shall be subject to the book-entry Treasury bill regulations set forth in Department of the Treasury Circular, Public Debt Series No. 26-76 (31 CFR, Part 350), and, to the extent applicable, to Department of the Treasury Circular No. 300, current revision (31 CFR, Part 306), the general regulations governing United States securities. Copies of the circulars may be obtained from a Federal Reserve Bank or Branch, or the Bureau of the Public Debt.

not effected by assignment and delivery of the treasury bills in definitive form, the treasury bills held as book-entries in accounts maintained by the Treasury may be withdrawn from such account by request made by or on behalf of the depositor, and transferred through the Federal Reserve Bank Communication system to an account maintained by or through a member bank under subpart B of the Regulations. (31 CFR 350.8). Once held in the account of a member bank, transfers may be effected by any means that would be effective under applicable law to effect a transfer of treasury bills if the treasury bills were maintained by the Reserve Bank in bearer definitive form. 31 CFR Section 350.4 (b). Thus the regulations specifically contemplate that book-entry treasury bills are transferable securities as that term is defined in Section 306.2 (q).

Goldman construes Section 350.16 (b) in isolation and from this basis arrives at the conclusion that "notice" as used in that section includes a *"summons"* to garnishee or an "order" of court directing the treasury department, as garnishee, to transfer Goldman's book-entry treasury bills on behalf of Goldman through the Federal Reserve system to a member bank to be sold on the market. The Court of Appeals construed Section 350.16 (a) and (b) as a whole and found that the word "notice" was not meant to include court orders and writs of execution. It held that Goldman's interpretation of that phrase was too narrow. (Note 9, Opinion, Court of Appeals, Petition Appendix, pp. A-23, A-24).

This court in dealing with regulations concerning savings bonds, made the following policy statement in *Free v. Bland*, 369 U. S. 663, 670, 82 S.Ct. 1089, 1094, 8 L. Ed. 2d 108:

> While affording purchasers of bonds the opportunity to choose a survivorship provision which must be recognized by the States, the regulations neither insulate the purchasers from all claims regarding ownership nor immunize the bonds from execution in satisfaction of a judgment.

The Solicitor General, appearing as amicus curiae, acknowledges that there is an exception implicit in the savings bond regulations, including the survivorship provision, so that federal bonds will not be a "sanctuary for a wrongdoer's gains."

The Court of Appeals properly ruled that treasury regulation 31 CFR 350.16 (b) did not exempt Goldman's book-entry treasury bills from execution and garnishment.

B

If Under 31 CFR 350.16(b), the Treasury Department Contracted With Goldman Not to Recognize Merrill Lynch's Writ of Execution and Summons to Garnishee Against Goldman's Book-Entry Treasury Bills, Then the Regulation Retroactively Deprived Merrill Lynch of Property Without Due Process in Violation of the 5th Amendment to the Constitution of the United States and Is Void as to Merrill Lynch's Transaction With Goldman.

Furthermore, if 31 CFR Section 350.16(b) is construed to prohibit recognition by the Treasury Department of valid judicial process in aid of execution on Merrill Lynch's judgment against Goldman, said regulation arbitrarily and capriciously deprives Merrill Lynch of the right to collect its indebtedness and judgment against Goldman and thereby deprives it of its property without due process of law in violation of provisions of the 5th Amendment of the Constitution of the United States.

The effect of construing 31 CFR 350.16(b) in such a manner is to cause said book-entry treasury bills to be exempt from execution and garnishment and impairs Merrill Lynch's ability to collect the debt which Goldman owes Merrill Lynch. The exemption as to Goldman's treasury bills would not be effective until Goldman invested his assets in treasury bills, which occurred after his indebtedness to Merrill Lynch became fixed on September 8, 1976. Goldman did not purchase the treasury bills until January and February of 1978 (Court of Appeals Decision, Petition Appendix, p. A-15). Furthermore, according to 31 CFR 350.0(a)(1), book-entry treasury bills could not be purchased until after December 1, 1976. Goldman's debt to Merrill Lynch existed before the exemption was created by regulation or was created by contract obligation between Goldman and the Treasury Department and the exemption constitutes an unwarrantable interference with Goldman's contractual obligation to Merrill Lynch in violation of constitutional provisions.

Rights acquired by a creditor before and after a judgment are property rights which cannot be taken without due process of law. The judgment and garnishment in the instant case afforded the appropriate means of enforcing Goldman's contractual obligations and the regulation, as well as the alleged contract made by Goldman with the Treasury Department after he had incurred a debt to Merrill Lynch, altered Merrill Lynch's substantial rights to have its existing debt paid. *W. B. Worthen Company v. Thomas*, 292 U. S. 426, 78 L.Ed. 1344, 54 S.Ct. 816, 93 ALR 173, 176 (1934). If 31 CFR 350.16(b) is construed, as urged by Goldman, to cause said book-entry treasury bills to be exempt from execution and garnishment, then it would retroactively impair Merrill Lynch's claim against Goldman. Article I, § 10 of the United States Constitution which prohibits a state from impairing the obligation of a contract, prevents a state from enacting a retroactive statutory exemption, without limitation or restriction, exempting property from liability for the payment of a debt. *W. B. Worthen Company v. Thomas*, supra. And the Federal Government may not under the due process clause so deprive a judgment creditor. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 559, 560-561, 79 L.Ed. 1592, 1604, 1611, 55 S.Ct. 854, 97 ALR 1106 (1935).

CONCLUSION

Respondent respectfully submits that petitioner would have this court review the findings of fact of the trial court in No. 78-1427 and find that those findings are clearly erroneous, a function this court has repeatedly declined to perform. As demonstrated herein, the opinion of the Court of Appeals indicates that the court carefully reviewed the evidence below and correctly found that the trial court's findings of fact was not clearly erroneous. Furthermore, the Court of Appeals found that the trial court considered each of Petitioner's alleged theories of fraud. Because Goldman was unable to prove fraud, he was not prejudiced by the trial court's dismissal of Count III. There is no need for this court to exercise supervisory powers under the circumstances.

Although the issues presented by the supplementary appellate proceeding No. 78-1622 may be of importance, the Court of Appeals correctly ruled that book-entry treasury bills are not a debtor's haven, and there is no need for this court to intervene.

It is therefore respectfully requested that this Honorable Court deny this petition for writ of certiorari.

Respectfully submitted,

EVANS & DIXON
HENRY D. MENGHINI
GERRE S. LANGTON
314 North Broadway
St. Louis, Missouri 63102
(314) 621-7755

Attorneys for Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.

ADDENDUM

ADDENDUM A

SECOND AMENDED COUNTERCLAIM

(Filed August 18, 1977)

Comes now Defendant Sam Goldman, and with leave of Court, states for his Second Amended Counterclaim against Plaintiff as follows:

Count I

1. That this Court has jurisdiction of this cause of action pursuant to the grounds set forth in Plaintiff's Amended Complaint.

2. That Defendant Sam Goldman (hereinafter "Goldman") is a resident of St. Louis County, and that Plaintiff is a corporation organized and existing by the laws of the State of Delaware, with one of its principal places of business in the County of St. Louis, Missouri.

3. That Plaintiff is a securities and commodities investment broker and advisor and is in the business of investments for itself and by and through its numerous domestic and foreign subsidiaries and is a member of various stock exchanges, boards of trade and exchanges dealing in various stocks, bonds, securities, commodities, futures and other financial instruments, including dealing with futures and contracts for the sale, among other items, of Mexican pesos issued by the Government of Mexico.

4. That commencing on or about the 4th day of May, 1976, and continuing for a subsequent period of time as hereinafter set forth, Plaintiff, acting by and through its agent, servant and employee, Stephen Palmen (hereinafter "Palmen"), a commodities broker licensed by the Commodities Future Trading Com-

mission, did discuss with Defendant Goldman the matter of said Defendant's investment of funds in various commodities and futures contracts, particularly Mexican peso contracts.

5. That during the period of the relationship between Plaintiff and Defendant Goldman, said Defendant was unsophisticated in the fields of commodity and other financial investments, and in particular, in the areas of futures trading, margin investments, and specifically Mexican peso contracts, all of which information Defendant Goldman related to Plaintiff, by and through said agent Palmen, and that Plaintiff knew and realized that Defendant was not knowledgeable in such areas.

6. That Defendant Goldman did indicate to Plaintiff, by and through its said agent Palmen, that he did not wish to become involved in any investment that was speculative or involved any significant degree of risk, whereupon said agent Palmen did indicate that Plaintiff would undertake to investigate and inquire into the financial propriety, suitability, stability, wisdom and feasibility of investing Defendant Goldman's funds in the purchase of Mexican peso contracts, and whether such an investment would be a safe investment.

7. That throughout Plaintiff's initial discussions with Defendant Goldman, conducted through its said agent, servant and employee, Palmen, it did represent and hold itself out to be a full service brokerage house and financial advisor and expert in the field of commodities trading, and specifically Mexican peso contracts, and indicated to Defendant that he should rely upon their expertise and recommendations, and otherwise place full confidence and trust in them.

8. That Plaintiff, acting through its said agent, servant and employee, Palmen, did indicate that it had a number of contacts and sources, both within its own organization, and elsewhere, particularly on the West Coast and in Mexico, from whom it

could make inquiry and determine the suitability and safety of Defendant investing his funds in Mexican peso contracts.

9. That Plaintiff, acting through said Palmen, as aforesaid, did so undertake to make inquiry and investigation as to the safety, security, and suitability of Defendant Goldman making such an investment, contacting both its own and other external sources and contacts, as aforesaid, and based upon those inquiries did represent that there was no possibility that the Mexican peso would be devalued during the year 1976, and that accordingly, investment in Mexican peso contracts was a safe and sound investment posing no risk to Defendant's investment capital.

10. That Plaintiff, by and through said Palmen, as aforesaid, did further represent to Defendant Goldman that it would use its financial expertise, information sources, and investment judgment to advise said Defendant how to invest his funds, especially in the field of commodities and Mexican peso contracts, and thus and thereby make a profit for Defendant.

11. That subsequently, (based upon the aforesaid representations made by Plaintiff, by and through its said agent, servant and employee, Palmen, and upon the advice and solicitations, as aforesaid,) Defendant Goldman ultimately delivered and entrusted to Plaintiff the approximate aggregate sum of Twelve Thousand Dollars ($12,000.00) for the purposes of purchasing Mexican future peso contracts, and that Plaintiff, by and through its agents, servants and employees, and in particular, said Palmen, did effect the purchase of Mexican peso contracts on the following dates: May 6, 1976; May 12, 1976; June 18, 1976; July 2, 1976; and August 11, 1976; all of which contracts were purchased on margin of less than ten percent (10%) of the total purchase price, and all of which purchases were transacted and brokered by Plaintiff and said Stephen Palmen.

12. That of the five (5) said peso contracts, the latter contracts were purchased for Defendant Goldman by Plaintiff by "pyramiding" said Defendant's paper profits on the earlier purchased peso contracts, all at the urging, suggestion, and advice of Plaintiff, and its agent, Palmen, as aforesaid, thereby not only generating additional commissions and income to Plaintiff, and its said agent, Palmen, but also for the purpose of Plaintiff and said Palmen gaining Defendant Goldman's confidence and trust in them, and thereby, also increasing the magnitude of said Defendant's financial commitment in Mexican peso contracts and his overall investment with Plaintiff.

13. That subsequently, on or about August 31, 1976, while Defendant Goldman was still holding said future peso contracts, and before their maturity date, the Government of Mexico did announce that the peso would no longer be supported at a fixed parity price, but rather would be allowed to "float" at the market value with reference to other world curriencies, which actions were in effect a de facto devaluation of the peso.

14. That as a result of said announcement and "devaluation," the trading value of the Mexican peso, and the contracts for the same in which Defendant had invested upon Plaintiff's and said Palmen's representations, urgings, and advice, did suffer a substantial drop in value of approximately one-half (½) and that as a result thereof, Plaintiff did request Defendant Goldman to deposit One Hundred and Twenty-five Thousand Dollars ($125,000.00) to cover the alleged drop in value and meet the margin requirements as claimed by Plaintiff, which request Defendant Goldman was unable to meet, and which request was wrongful and improper in that it was occasioned by the failure of the investments suggested by Plaintiff, and its said agent, to be of the quality, safety, and stability represented, as hereinbefore set forth.

15. That Plaintiff did subsequently liquidate and cash out Defendant Goldman's margin account on or about September 9, 1976, thereby causing Defendant to lose his total investment capital aggregating approximately Twelve Thousand Dollars ($12,000.00).

16. That Defendant Goldman's loss, as aforesaid, was a direct and proximate result of the fraudulent and wrongful misrepresentations made by Plaintiff and its agent, servant and employee, Palman, with respect to the representation that investment in Mexican peso contracts was a safe and sound investment, and for the further misrepresentation that Plaintiff and its agent Palmen had an "inside source" upon which they represented that there was no chance that the peso would be devalued in 1976, all of which representations were false, and which Plaintiff and said Palmen knew, or should have known, were false, but which were made with the intent that Defendant Goldman should rely upon them, and that he did so in fact rely upon them, and which representations were material, and were made for the utlimate purpose, and with the intent, to defraud Defendant into investing and entrusting his monies to Plaintiff and said Palmen for their benefit, all of which actions were contrary to and in violation of the duties owed by Plaintiff and its agent Palmen to Defendant Goldman to protect and preserve Defendant Goldman's investment interests and to avoid such losses, and which did damage Defendant Goldman and result in the loss of the sum of Twelve Thousand Dollars ($12,000.00).

17. That the actions and misrepresentations of Plaintiff, acting by and through its agents, servants and employees, and in particular said Palmen as hereinbefore set forth, did represent a violation of the Commodities Exchange Act, and in particular 7 U.S.C., Section 6(b) and (o).

18. That the actions of Plaintiff and its agent were wrongful and unlawful and done with a willful and malicious intent to

enrich itself at Defendant's expense and without regard for Defendant Goldman's financial well-being or the security of his investments, and that before Defendant Goldman is entitled to punitive damages in the sum of Five Hundred Thousand Dollars ($500,000.00).

WHEREFORE, Defendant Goldman prays judgment against Plaintiff for his actual damages in the sum of Twelve Thousand Dollars ($12,000.00), and for further judgment in the sum of Five Hundred Thousand Dollars ($500,000.00) punitive damages, together with interest thereon and the costs of this action, and for such other and further relief as to the Court seems just and proper.

Count II

Comes now Defendant Sam Goldman, and for Count II of his cause of action, states as follows:

19. Defendant herein adopts and reincorporates by reference, as if fully set forth herein, paragraphs 1 through 18 of Count I herein.

20. That the activities and misrepresentations of Plaintiff, and its agents, servants and employees, especially said Palmen, as aforesaid, regarding investment in Mexican peso contracts were part of a larger overall scheme, artifice and device to defraud and entice Defendant Goldman into investing greater sums of money with Plaintiff.

21. That these activities and misrepresentations of Plaintiffs and its agents, servants and employees, were intended as an inducement to initially obtain Defendant Goldman as a client, and to subsequently solidify its hold upon Defendant Goldman by committing said Defendant to commit large sums of monies in various commodities, investments and futures trading, and thus and thereby to cause said Defendant to become dependent upon

Plaintiff and its agent Palmen for advice and guidance to protect his investments.

22. That the object of Plaintiff's and Defendant Palmen's scheme, and the activities comprising it, was to induce Defendant Goldman to commit Fifty Thousand Dollars ($50,000.00) of his funds to Plaintiff in what was known as a guided investment program in commodities which Plaintiff offered, wherein Plaintiff would be given Fifty Thousand Dollars ($50,000.00) by Defendant Goldman to invest in various commodities and futures transactions and investments as Plaintiff saw fit, and at its discretion; which investment program represented a profitable and lucrative source of business to Plaintiff.

23. That as a result of Plaintiff's and its agent Pulmen's activities in perpetrating the aforesaid fraud upon Defendant Goldman, said Defendant was damaged in the amount of Twelve Thousand Dollars ($12,000.00), representing that portion of his investments which were lost, as set forth in greater detail in Count I.

24. That the activities and scheme of Plaintiff was wrongful in that:

(a) The initial misrepresentations concerning the safety and stability of the Mexican peso, which were made to induce Plaintiff to invest his funds and become a client of Merrill Lynch, were falsely, fraudulently, and recklessly made, all as hereinbefore set forth in Count I;

(b) Plaintiff and its agents, servants and employees, especially said Palmen, failed and omitted to advise Defendant Goldman, in the course of their dealings, either orally or in writing, that investment in any commodities or futures transaction was inherently speculative and involved a high degree of risk, which failure and omission was contrary to both good brokerage practice and market

exchange rules and regulations then operating upon Plaintiff and governing the transactions;

(c) That in the course of inducing and encouraging Defendant Goldman to commit greater sums of his funds into investments with Plaintiff, thereby increasing its hold over Defendant, Plaintiff, by and through its agents, servants and employees, especially said Palmen, caused excessive credit to be extended to Defendant Goldman, which actions were wrongful, unlawful, and improper in that:

(1) Said excessive credit exposed Defendant Goldman to investments of a greater magnitude and risk far beyond his means and ability;

(2) Such activities were contrary to good brokerage practice and conduct, and the duties owed Defendant Goldman arising from the broker/client relationship; and

(3) Such activities violated Plaintiff's own house rules and corporate policies pertaining to the extension of credit and margin, as set forth in greater detail in Count III herein.

(d) Defendant Goldman, by Plaintiff's own standards, house rules, and corporate policy, did not qualify, either in terms of financial ability, worth, and holdings, or investment personality and temperament, for the type of investment programs, guided or otherwise, which Plaintiff, and its agents, servants and employees, especially said Palmen, involved, or attempted to involve, Defendant Goldman in, as set forth in greater detail in Count III herein;

25. That because of the wrongful nature of Plaintiff's and its agent Palmen's activities, as aforesaid, and particularly in consideration of the fact that this is not the first time Plaintiff

has shown such a reckless disregard for the welfare, financial and otherwise, of its customers and clients, all of which evidences a wanton, willful and malicious intent and attitude on its part, punitive damages in the sum of Five Hundred Thousand Dollars ($500,000.00) are justified, both as punishment to Plaintiff for its misdeeds already committed as against Defendant Goldman, and as an exemplary incentive and example to prevent and deter Plaintiff and others who would engage in similar misconduct and misrepresentations in the future.

WHEREFORE, Defendant Goldman prays judgment against Plaintiff in the sum of Twelve Thousand Dollars ($12,000.00) for his actual damages, and Five Hundred Thousand Dollars ($500,000.00) punitive damages, and for interest on his monies expended from the date of investment, and for his costs expended herein.

Count III

Comes now Defendant Sam Goldman and for Count III of his cause of action, states as follows:

26. That Defendant herein adopts and reincorporates Counts I and II, and all paragraphs thereof, as if fully set forth herein.

27. That Plaintiff, at all times hereinbefore mentioned, acting as broker for Defendant Goldman, had a basic duty to supervise and review said Defendant's commodities trading account, both as a matter of law and under its own business rules and policies (which rules and policies are hereinafter set forth in greater detail), to determine what kind of trading account and margin credit limits Defendant qualified for, if any, as well as to periodically review Defendant's trading activities and accounts to insure their compliance within the trading activities and limitations set for said Defendant.

28. That Plaintiff, at all times mentioned herein, was the employer and principal of said Palmen, and in such capacity had a duty to supervise and review all actions and conduct of said Palmen's methods of handling the affairs and activities of Defendant Goldman's commodities trading account to insure that its own duty and responsibility to Defendant Goldman, as aforesaid, were being carried out and fulfilled as provided by law and by its aforesaid own rules.

29. That among the policy statements and rules which Plaintiff has adopted to effectuate the same are the following:

(a) That Merrill Lynch Rules 05.32.1, 09.12, and Policy Bulletin No. 76-12 set certain Acceptance Standards for commodity accounts, included among which is the requirement of an annual income of Twenty-five Thousand Dollars ($25,000.00);

(b) That the aforesaid two (2) Rules also state that:

> As a basic policy, the Corporation does not wish to handle speculative commodity business for individuals who cannot afford the risks, and for those who are temperamentally not suited to commodity trading.

(c) Said Rules further state that:

> We do not wish to handle speculative commodity business for individuals with small net worth or small annual income. *Neither do we wish to handle business for those individuals regardless of net worth or income whose losses would be detrimental to their standard of living nor* for those whose family responsibilities are such that any loss of capital would *impair the financial security of the individual* and his dependents. (Emphasis added).

(d) Rule 05.32, governing approval of new accounts states that:

> . . . all persons who exercise this authority [to approve new accounts] on behalf of the Corporation should be aware of the responsibility imposed on them by Rule 405 to use due diligence when approving new accounts.

and continues that:

> The consequences of incomplete or incorrect information on a new account form are the responsibility of the individual accepting the account as well as the account executive who opens it.

30. That Plaintiff and said Palmen, in permitting Defendant Goldman to open a commodities trading account, breached their duty to Defendant Goldman in that said Defendant did not qualify for the following reasons:

(a) Defendant did not have an annual income of Twenty-five Thousand Dollars ($25,000.00); his own income in fact being substantially beneath that required amount;

(b) That Defendant Goldman was, at all times relevant herein, sixty-five (65) years of age, semi-reitred, and basically living on a fixed income, and therefore neither financially nor temperamentally suited to engage in commodities trading and the extreme risks inherent therein; and

(c) That the type, degree, and magnitude of the commodities trading and investment activity which Plaintiff and its said agent Palmen permitted Defendant Goldman to engage in involved such risks and exposed said Defendant to such potentially large unsecured liability (almost Four Hundred Thousand Dollars ($400,000.00)) that the realization of even a small portion of said potential liability,

as is in fact presented by Plaintiff's claim for almost One Hundred and Twenty Thousand Dollars ($120,000.00), would be detrimental to Defendant Goldman's general standard of living and impair his financial security.

31. That notwithstanding Plaintiff's and its said agent Palmen's failure to effectively screen Defendant Goldman's qualifications and suitability to engage in commodities trading. Plaintiff and said Palmen further breached their duty to Defendant Goldman in the following respects:

(a) That said Palmen failed to use due diligence, as required by Merrill Lynch Rule 05.32, as aforesaid, in obtaining the financial information on Defendant Goldman necessary to establish his commodity trading limits, and as required by Plaintiff's New Accounts form; and that Plaintiff's office manager, one Boynton Hussey, as agent, servant and employee of Plaintiff, also failed to exercise due diligence, as required by Merrill Lynch Rule 05.32, both in approving said New Account form and in accepting Defendant Goldman's account;

(b) That the New Accounts form filled out by said Palmen indicated Defendant Goldman had a net worth of Two Million Dollars ($2,000,000.00) and an annual income of Fifty Thousand Dollars ($50,000.00), which information was wrong and inaccurate; Defendant Goldman's actual financial worth, at that time, being approximately Two Hundred and Thirty Thousand Dollars ($230,000.00), and his annual income then being approximately Sixteen Thousand Dollars ($16,000.00);

(c) That based upon the unverified and inaccurate information, as aforesaid, Plaintiff nonetheless extended Defendant Goldman a line of credit with margin deposits limits of Twenty-five Thousand Dollars ($25,000.00), thereby permitting said Defendant to purchase investments carry-

ing obligations many times that amount, which margin trading limits were excessive and which in fact ultimately led Plaintiff to permit Defendant Goldman to purchase the aforesaid five (5) Mexican peso contracts with a potential unsecured liability of approximately Four Hundred Thousand Dollars ($400,000.00); which sum was substantially in excess of said Defendant's net worth;

(d) That notwithstanding the wrongfulness and excessiveness of the line of credit and margin trading limits extended by Plaintiff to Defendant Goldman, as aforesaid, both Plaintiff and its said agent Palmen nonetheless permitted Defendant Goldman to exceed the margin trading limits Plaintiff had set for Defendant Goldman by Seven Thousand Dollars ($7,000.00), which further compounded said Defendant's investment over-exposure;

(e) That it was not until on or about August 16, 1976 that Plaintiff finally became aware that Defendant Goldman was over the authorized margin trading limits Plaintiff had established for him, but that no action was taken to reduce said Defendant's trading position to within those margin trading limits established by Plaintiff, such that when the peso "devalued," on or about August 31, 1976, over two (2) weeks later, said Defendant's trading position was still over-extended, such that the subsequent loss of investment capital was almost thirty percent (30%) greater than it otherwise should have been; and

(f) That it was not until on or about August 20, 1976, well over three (3) months since Defendant Goldman's line of credit and margin trading limits had been established, that Plaintiff recognized a substantial discrepancy between Defendant Goldman's financial net worth and annual income as indicated by Defendant Palmen on the New

Account information form ($2,000,000.00/$50,000.00) and between the information indicated on a credit report requested and received by Plaintiff shortly after the account was opened indicating that Defendant Goldman had a net worth of Four Hundred and Seventy Thousand Dollars ($470,000.00) and an annual income of Thirty-two Thousand Dollars ($32,000.00) (neither of which reports were accurate as aforesaid); by which time Plaintiff had already permitted Defendant Goldman to trade beyond even Plaintiff's own inflated margin trading limits established by it for Defendant Goldman.

32. That the negligence of Plaintiff's failure and omission to screen Defendant Goldman as a prospective client, or to supervise and review his account and trading activities once it was opened, was compounded by Plaintiff's failure to supervise the activities of its said agent Palmen insofar as Plaintiff knew, at the time it was considering the hiring of said Palmen:

(a) That said Palmen had been the subject of several formal complaints and objections by former customers at his previous place of employment regarding the handling of their accounts; and

(b) That a response from said Palmen's former employer to a questionnaire prepared by Plaintiff indicated that the former employer would not re-employ said Palmen because of the existence of the aforementioned formal complaints, and because of said Palmen's attitude toward resolving those complaints.

33. That Plaintiff has, and at all times relevant herein, did hold itself out to be a reputable, responsible full service brokerage house and whom the public generally, and Defendant Goldman specifically, should place their trust and confidence and that

the foregoing policies and rules promulgated by Plaintiff were for the benefit and protection of Defendant Goldman, who had a right to rely upon them, and who did in fact rely upon them, and upon the integrity with which Plaintiff represented and held itself out to Defendant Goldman and the public generally.

34. That as a direct and proximate result of Plaintiff's and its agent Palmen's failure at self regulation, and to exercise due diligence and basic supervision of Defendant Goldman and his account, said Defendant was caused and allowed to invest the sum of Twelve Thousand Dollars ($12,000.00), which sum was lost as a result of Plaintiff's and said Palmen's negligence, as aforesaid.

WHEREFORE, Defendant Goldman prays judgment against Plaintiff for the sum of Twelve Thousand Dollars ($12,000.00) together with interest thereon, for the costs of this action, and for such other and further relief as to the Court seems just and proper.

Count IV

Comes now Defendant Sam Goldman and for Count IV of his cause of action, states as follows:

35. That Defendant herein adopts and reincorporates Counts I, II and III, and all paragraphs thereof, as if fully set forth herein.

36. That during the course of the investment relationship between the parties, during which time Defendant Goldman purchased the aforesaid five (5) peso contracts, Plaintiff, by reason of its dominant position in the international investment community, and in particular by reason of its close relationship with the Government of Mexico arising out of several substantial

bond issues which it was underwriting, had inside information relating to the imminent and pending "devaluation" of the peso.

37. That during the aforesaid period of time when Defendant purchased said peso contracts, Defendant has reason to believe, and does believe, that Plaintiff did divulge this advance information to certain of its preferred, selected customers and investors.

38. That Defendant has reason to believe, and does believe, that these preferred customers and investors did make purchases and/or sales based upon this inside information during the same period of time when Defendant was engaged in the purchase of the aforesaid five (5) peso contracts.

39. That in so doing, Plaintiff was acting fraudulently and deceitfully with an intent to defraud other, noninformed investors, including Defendant, who purchased during this same period of time.

40. That the knowledge of the pending "devaluation" of the peso was a material piece of information, which did have a substantial effect upon the investment market.

41. That the disclosure of this information to certain insiders and selected and preferred customers was wrongful by Plaintiff, and done with an intention of manipulating the market in favor of certain preferred customers, and to Plaintiff's advantage.

42. That in so acting, Plaintiff was acting with a reckless disregard for the truth and for the financial welfare of Defendant and his investments.

43. That as a direct and proximate result of said actions by Plaintiff, Defendant was damaged in the sum of Twelve Thousand Dollars ($12,000.00).

WHEREFORE, Defendant prays judgment against Plaintiff in the sum of Twelve Thousand Dollars ($12,000.00).

Respectfully submitted,

HENRY J. FREDERICKS
FRIEDMAN & FREDERICKS
Attorneys for Defendant Goldman
7730 Carondelet Avenue
Clayton, Missouri 63105
725-3322

ADDENDUM B

Transcript of Trial, Cross-Examination of Boynton Hussey, and Goldman's Opening Statement, Tr. pp. 49-59.

* * * * * * *

[49] Q. Mr. Hussey, I next show you Exhibit 9 and 9A and ask you what they are requesting?

MR. MENGHINI: Your Honor, again, these exhibits and this information is all information that the Merrill Lynch Company was gathering for its own information, and we're not getting back to what contending is a violation of a house **[50]** rule or our own rules. Your Honor has already dismissed count three which we moved to dismiss. It was filed in the counterclaim which raised that very question. That's not a part of this case and I am going to object on the basis of relevancy.

MR. RADLOFF: First of all, 9 and 9A are Mr. Palmen's requests that the margin limits be raised.

MR. MENGHINI: That's right, within our own houses requesting that margin limits be raised. How that's relevant to this case I fail to see.

MR. RADLOFF: And I explained, or Mr. Fredericks explained a great deal of this defense, Your Honor, goes to the fact that Mr. Palmen, as we allege was defrauded or attempting to be defrauded into getting involved in this guided investment program and that to have qualified him in the guided investment program, Mr. Palmen would have had to request that Mr. Goldman's trading limits which had only been $25,000 be raised to the minimum of $50,000 which is the minimum requirement.

MR. MENGHINI: That has not been established, and in any event that's nothing more than a house rule.

THE COURT: Well, I understand that, but the facts are, as I understand it, and you'll correct me if I am wrong, he did not get in this program. Is that right?

[51] MR. RADLOFF: That's correct, Your Honor.

THE COURT: All right. Then I don't want to hear any more about this program.

MR. RADLOFF: May I cite you one point. Part of our case, Your Honor,—it's in two parts—even in count one. It's common law fraud and it's also statutory violation of Commodities and Exchange Act, and under Section (6) (b) it covers an attempt to cheat or to defraud, and that is a basis upon which we are——

THE COURT: I understand that's an attempt, but he didn't get into it.

MR. RADLOFF: But they committed the attempt. They were attempting to hook him to get into commodities by getting him first involved with pesos. From there they would have escalated his investments. Unfortunately, the market collapsed before they could get him involved in the $50,000 program.

THE COURT: Well, since you haven't made a statement of what your case is all about, and the Court hasn't had the benefit of that, I really don't know what your case is all about. So why don't you just get over there now and tell me what you're contending about this case. I'd like to hear about it so I will be informed.

MR. RADLOFF: Do you want to do it?

[52] MR. FRIEDMAN: No, you do it.

MR. RADLOFF: Your Honor, on the basic transactions, as we have stated before, there is no agreement, but the gist of our case deals with the allegation on our part that Mr. Goldman was induced to enter into these peso transactions on the basis of certain misrepresentations that were made to him by

Mr. Stephen Palmen as the account executive of Merrill Lynch. There is a divergence of facts when we get to the initial meeting of May the 4th. That was Mr. Goldman's first contact with Merrill Lynch. He had received this so-called McKeever's letter. He was not a subscriber; he had never requested it. It came in the mail unsolicited to him.

It mentioned the fact that high rates of returns were possible by investing in these so-called Mexican pesos futures contracts, and Mr. Goldman, I think, read the article sometime in April when he received it, kept it in the back of his head, and then eventually got around to calling Merrill Lynch to inquire about these things.

He had no experience previously in commodities or even stocks and bonds actually.

At that time, as Mr. Menghini indicates, he went to Merrill Lynch—he made a phone call first, was put in touch with Stephen Palmen, account executive who suggested, "Why don't you come in? We'll talk about it." He indicated, **[53]** "If you are interested bring $7,000." That would be the margin requirement.

Mr. Goldman didn't bring any margin money with him that day. He wanted to talk about it and find out about what these investments were all about.

Now, Mr. Goldman will indicate in his testimony that he went in, he brought the article with him, this McKeever's letter as it's called, and asked for Merrill Lynch of Mr. Palmen in particular to explain to him what it was all about and what kind of risks, if any, are involved in it. Does it indeed have this high rate of return?

And Mr. Palmen indicated that he would contact their people to find out about this investment, and he first indicated that

he contacted Merrill Lynch's people in the Chicago Monetary Market on the International Monetary Market.

His response there was coupled with another response that he indicated he had called their people in California, that they have a source in the West Coast who was very close to Mexico. And Mr. Goldman was informed that on the basis of these two calls that, number one, the peso is a safe commodity and, number two, there will be no devaluation in Mexico at least not until after December of 1976 as that is when a new election had been held and the new president was to take office. So until that change of **[54]** administration took place, Merrill Lynch could assure Mr. Goldman that there would be no devaluation.

On that basis primarily, Mr. Goldman went ahead and committed $7,000 which he brought back the next day. He did not have the money with him that day until he found out about this investment.

He came back the next day; he brought $7,000 with him and at that time he filled out Exhibits 2 and 3 which is the authority to Merrill Lynch to act as agent and to place the contracts and make the deposits of the funds.

Now, at that time there was also new account information sheet that Stephen Palmen caused to be filled out. There was a great difference here of fact because it is the information on that new account sheet reflecting Mr. Goldman's background which is also part of our lawsuit, that this misrepresentation was made by Mr. Palmen of the information in that sheet so that he could convince his superiors to allow Mr. Goldman to trade at these more advanced programs that Merrill Lynch offered.

Now, on that sheet there are such facts that Mr. Goldman was a married individual, that he was a manufacturer's repre-

sentative, that he had income of approximately two million dollars and that he had an annual income or a net worth of two million dollars and an annual income of about **[55]** $50,-000, none of which Mr. Goldman gave Mr. Palmen.

The only information Mr. Goldman gave Mr. Palmen was basic facts as to his name, address, two bank references, and that was it. Mr. Goldman never signed Exhibit Number 1.

At that point, as I say, Mr. Goldman didn't know of the existence of this document until much further on in the September 7 meeting.

In any event, in the course of dealing with Mr. Goldman and Mr. Palmen at Merrill Lynch over the next four months during which time these next five contracts were purchased, it is Mr. Goldman's position that he will so testify that during this period of time he came to rely very heavily on Mr. Palmen; he didn't know anything about the commodity markets; he didn't know anything about the concept of taking delivery and fluctuations involved, and he relied quite heavily on Mr. Palmen for his knowledge and expertise, and that Stephen Palmen through the course of these dealings would at numerous times make suggestions to Mr. Goldman as to what to buy and what not to buy, when to buy another peso, things like that, and that throughout this entire period beginning from the very first meeting and sporadically throughout, Mr. Palmen was always pushing Mr. Goldman about getting into this $50,000 guided investment program.

And we are prepared to put on evidence which will **[56]** show that this program was indeed a very lucrative source of income to Merrill Lynch. $50,000 program in a year's time would normally turn about 400 to 450 transactions. At $50 a transaction that's over a $20,000 a year in commissions for which the individual broker himself got 27 per cent which comes to over $5,000 for him.

And it is that basis that we allege that there is what amounts to a conspiracy, although we are not pleading a conspiracy, but what is tantamount to a scheme to defraud Mr. Goldman first by getting him hooked on pesos and indeed, if the market had held steady, he would have gotten a very handsome return which would have made Merrill Lynch look very good and then eventually get him into this more lucrative which was much more profitable to Merrill Lynch insofar as we believe it appears that the Mexican peso contract was only a lost leader, so to speak.

And that basically is the gist, that he was misrepresented on the actual peso investment and also as to this larger, overall scheme to hook him into making these larger commitments of money to Merrill Lynch.

THE COURT: Let me ask you this: do you contend it is fraudulent to get into that program of investment with Merrill Lynch?

MR. RADLOFF: We do, Your Honor, because Mr. **[57]** Goldman was nowhere near to be qualified as to the type of individual who should invest in that type of program.

THE COURT: What is the basis of that now?

MR. RADLOFF: These misrepresentations about Mr. Goldman's financial background. Had the truth been known from the very beginning, and had Mr. Hussey and other people who supervised and review these new accounts known the background of Mr. Goldman, there was no way, either Merrill Lynch's standards or just good general broker knowledge in the industry that Mr. Goldman should have been allowed to get involved in these type of commodities.

THE COURT: Well now, is it your contention that Merrill Lynch has a rule?

MR. RADLOFF: Merrill Lynch has a rule which we believe reflects——

THE COURT: What is the rule?

MR. RADLOFF: The rule is—I have it here, Your Honor. I haven't the specific number, but in essence what it does is it reflects and re-incorporates the "Know your customer rule" of the New York Stock Exchange, that a brokerage firm is bound to investigate and to go to some lengths to find out all that they can about their customer as to evaluate his ability to trade in the particular commodity or security or whatever the investment is.

[58] THE COURT: I understand that, but what is the—what is the rule that Merrill Lynch violated?

MR. RADLOFF: In part, Your Honor, that is reflected by the Hecht opinion which sets forth the standard and duty of a brokerage company to know the customer, to accurately set forth the information about him, to find this out, to verify it, things of that nature, and it's also reflected again in their own house rules.

THE COURT: Which is what?

MR. RADLOFF: Which we have here—let's see. Okay. This is from Merrill Lynch's house rules, Your Honor, and reflects the rule 405 which they incorporate, I think.

THE COURT: What is 405?

MR. RADLOFF: Here it is, Your Honor.

THE COURT: Where's the rest of that rule?

MR. RADLOFF: That was all that Mr. Menghini furnished us. That is in response to our interrogatories to identify rule 405 and that is the response that Merrill Lynch furnished us with.

THE COURT: Okay.

MR. RADLOFF: We had also cited to the Court on Hecht the page 438 where we believe it specifically sets forth the depth and detail of this duty to know their customer as a matter of law and good brokerage practice.

[59] THE COURT: All right. Continue. Go ahead.

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